



MONTANA  
TELECOMMUNICATIONS  
ASSOCIATION

Statement of

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Before the

U.S. House of Representatives  
Energy and Commerce Committee  
Subcommittee on Telecommunications and the Internet

“Universal Service: What Are We Subsidizing and Why?”

June 21, 2006

Mr. Chairman and distinguished members of the Committee, my name is Geoff Feiss, General Manager of the Montana Telecommunications Association. It is an honor to be invited to share with you my perspectives on the reasons why we have universal service and the benefits it provides to all Americans, no matter where they may live.

I will address what universal service means to residential and business consumers particularly from a Montana perspective, and how universal service is integral to deploying a national infrastructure on which all Americans derive direct economic benefits. I'll close by addressing some of the deficiencies that have evolved in the universal service program today and discussing some more common criticisms of universal service, and—hopefully—I'll mitigate those concerns.

In brief, universal service is vital for ubiquitous access to affordable, quality, telecommunications capabilities on which our economy increasingly is dependent. That is not to say that problems don't exist. They do. And it's encouraging to see this Committee address the problems—and the substantial, tangible benefits—of universal service at this hearing.

#### Universal Service in Montana

Montana is the nation's fourth largest state. If you were to superimpose Montana over the eastern part of the United States, the northwest corner of the state would overlie the suburbs of Chicago, and the southeastern corner would touch the suburbs of Washington D.C. Yet, we have fewer than one million residents. Our largest city is Billings, with a population of about 100,000. We

also rank somewhere between 45<sup>th</sup> and 49<sup>th</sup> in per capita income, depending on whose statistics you use.

From a telecommunications network point of view, Montana's independent rural telecommunications providers serve about one-third of the telecom consumers of Montana, but our networks cover roughly 80% of the state's geography: about 120,000 square miles. On average we serve three access lines per mile. Western Montana is relatively more populated than Eastern Montana, where the average access line per mile is less than one.

Despite the significant barriers to development posed by tremendous distances between very few customers, commonly referred to as the "distance and density" dilemma,<sup>1</sup> Montana's independent rural telcos are key drivers for economic development throughout the state. With an annual payroll of over \$50 million, these companies employ over 1,000 Montanans with well paying jobs and competitive benefits. They often are the largest taxpayer in counties where they operate.

As important, Montana's rural telcos have deployed modern, efficient, affordable, advanced telecommunications capabilities throughout the state for the direct benefit of Montana's residential and business consumers. They are doing exactly what Congress intended universal service to do, as outlined in the principles of universal service under Sec. 254(b).<sup>2</sup> (See below.) The quality of these networks is unquestioned. Consumers simply assume calls will go through, 911 will work, etc.

Montana's rural telcos have deployed well over 5,000 miles of fiber optic backbone facilities throughout the state. They have pushed high-quality, secure broadband capabilities out to the edges of their networks so that between 80%

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<sup>1</sup> For a thorough discussion of the challenges associated with deploying rural telecommunications networks, see White Paper #2 of the Rural Task force, an independent advisory panel appointed by the Federal-State Joint Board on Universal Service to provide guidance on universal service issues affecting the telecom industry. The panel comprised experts from all facets of the industry, including local, long distance, wireline, wireless, etc.

[http://www.wutc.wa.gov/rtf/old/RTFPub\\_Backup20051020.nsf/?OpenDatabase](http://www.wutc.wa.gov/rtf/old/RTFPub_Backup20051020.nsf/?OpenDatabase). January, 2000.

<sup>2</sup> 47 U.S.C. 254(b).



and nearly 100% of Montana's rural telco consumers have access to broadband service. That's better than South Korea, the world's most connected country by some accounts. Broadband service is available to over 250 Montana communities, and that's saying something when the largest city in our state has a population of 100,000. The vast majority of Montana's broadband-capable towns has fewer than 1,000 residents. (It's interesting to note that broadband's popular support continues to grow: many Montana rural telcos report that over 50% of their Internet customers subscribe to broadband service.)

Montana's rural telcos also have formed consortia, to leverage resources and better serve their markets. One such consortium is VisionNet, which provides advanced videoconference and Internet access services. Over 130 video conference sites are deployed throughout the state. There is at least one, and often more than one, VisionNet site on each of Montana's Native American reservations. On an average school day, 60 to 80 hours of K-12 classes are taught using VisionNet's videoconferencing network. VisionNet also facilitates Telemedicine applications connecting rural health clinics to urban medical centers on a real time basis. Vital health care services now are reaching rural consumers as a result of broadband applications made possible by rural telcos.

As a result of the investment that Montana's rural telcos have made in advanced telecommunications infrastructure, a Cisco software engineer can live in Canyon Creek, Montana, and serve clients anywhere in the world, thanks to investment made by her local telecom provider, Lincoln Telephone Company. A programmer from Los Angeles who designs video graphics for national professional exams, directs plays in the summer from Virginia City, Montana. He continues to operate his graphic design business from Virginia City, thanks to access to DSL technology provided by 3 Rivers Telephone Cooperative. At the remote Great Divide Ranch near Philipsburg, Montana, the non-profit Project Vote Smart provides online access to factual and unbiased information about 40,000 political candidates in every state. Project Vote Smart's access to advanced broadband telecommunications services from Blackfoot Telephone

Cooperative makes the non-profit's databases available to its 45,000 members and voters nationwide. And Pixar Entertainment, the movie company responsible for *Toy Story* and other hits, is putting a studio in Kalispell, Montana, thanks to the combination of an unbeatable quality of life, and the quality of telecommunications facilities provided by CenturyTel.

### National Telecommunications Infrastructure

Much as the national highway system makes it possible for goods to get from one place to another efficiently, the national telecommunications infrastructure enables information to get from one place to another. While the volume of traffic may be greater in Los Angeles or New York than in Forsyth, Montana, it is still essential that our nation's information highways reach from one coast to another, and all points between. Ubiquitous access to telecommunications is essential so that the rancher in Montana can sell beef on a real time basis on the Chicago Board of Trade so that diners in Boston can benefit from efficiencies realized in the distribution of the steak they purchase at their supermarket. Similarly, consumers and businesses benefit from products and services from other states. Amazon.com and E-bay are just to examples of how information technology has influenced our economic lives.

It is an economic policy given that ubiquitous deployment of advanced telecommunications capabilities is essential to national competitiveness. Policy-makers frequently have noted the less-than-enviable position of the United States in relation to its international trading partners regarding deployment of broadband capability.<sup>3</sup> The President and members of Congress on both sides of the aisle have called for nationwide deployment of broadband capabilities; and as noted above, Montana's rural telcos are committed to such broadband deployment throughout their service areas.

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<sup>3</sup> See Organisation for Economic Cooperation and Development (OECD). Broadband Statistics, December, 2005.  
[http://www.oecd.org/document/39/0,2340,en\\_2649\\_34223\\_36459431\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/39/0,2340,en_2649_34223_36459431_1_1_1_1,00.html).

The investment made by rural telecom providers into a national information network infrastructure enables a panoply of telecommunications-related applications, services, and businesses—the network isn't just for telephone calls anymore. For example, much attention is paid to wireless capabilities. The fact remains, however, that wireless capabilities are wireless only for the “last mile” connection from a network point of interconnection to the end-user. In other words, “wireless” traffic relies on an underlying wireline (or fiber) infrastructure.

Similarly, the newest kid on the block, voice over Internet protocol, or VOIP, is nothing more than a software application that is installed on a computer that acts as a telephone. VOIP relies on a broadband connection, which itself relies on an underlying advanced telecommunications infrastructure.

In short, telecommunications is the foundation of modern economies. Universal service supports the nation's investment in ubiquitously-accessible underlying telecommunications infrastructure. Does universal service pay for broadband assets, per se? No; not directly. But continual investment in upgrading underlying telephone networks enables advanced capabilities to be deployed on a modern telecommunications platform.

Returning to the highway analogy, modern automobiles and trucks would be of little use today if the underlying highway system built in the 1950s weren't able to support modern vehicular traffic.

### Three-Legged Stool

How is investment in advanced telecommunications infrastructure possible? All local exchange carriers rely on three main sources of revenue from which to recover their substantial investments in telecommunications plant: revenues from ratepayers/customers; revenues from intercarrier compensation (what telecom networks charge one another for access to their networks by other carriers completing calls to or from one another); and universal service, designed

to ensure that consumers have access to affordable, quality telecommunications service. All providers of interstate telecommunications are supposed to contribute to the universal service support mechanism, and companies whose costs exceed a benchmark cost are able to receive support from the Universal Service Fund in order to maintain access by consumers to affordable, quality service. Access (intercarrier compensation) revenues and universal service together comprise between 50% and as much as 80% of rural telcos' revenues. In contrast, urban carriers rely far less on either access or universal service since their networks in general are lower cost and serve more densely populated areas. Moreover, the larger carriers rely less on access payments since they effectively pay themselves access to originate and terminate long distance traffic on their own networks; so access revenue does not constitute as significant a revenue stream as it does for rural carriers, who rely on other carriers to complete long distance traffic.

Without universal service, Montanans would pay an additional \$330 per year on average. Nearly 100,000 Montanans (10% of our population) would face increases of between \$300 and \$600 annually.<sup>4</sup> Given the fact that we are one of the nation's lowest per capita income states, this is real money. Moreover, it is entirely likely that even with tremendous rate increases, rural telcos' ability to maintain adequate investment in advanced telecommunications networks capable of supporting modern applications, services and features, would be severely threatened.

In other words, the "three-legged" stool must remain standing if Americans are to continue to benefit from a ubiquitously available, affordable, quality telecommunications infrastructure.

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<sup>4</sup> Universal Service Administrative Corporation (USAC): 3Q 2005; Appendices HC 01 and HC 05.

### What's Wrong with Universal Service Today?

The reasons for, and benefits of, universal service are as valid today as they were when Congress passed the Telecommunications Act of 1934, and codified universal service policy in 1996. As provided in Section 254(b) of the Telecommunications Act of 1996, universal service is based on the following principles:

1. quality services available at just, reasonable and affordable rates;
2. access to advanced services;
3. access in rural and high cost areas;
4. equitable and non-discriminatory contributions;
5. specific and predictable support;
6. Such other principles that may be determined appropriate for the protection of the public interest.

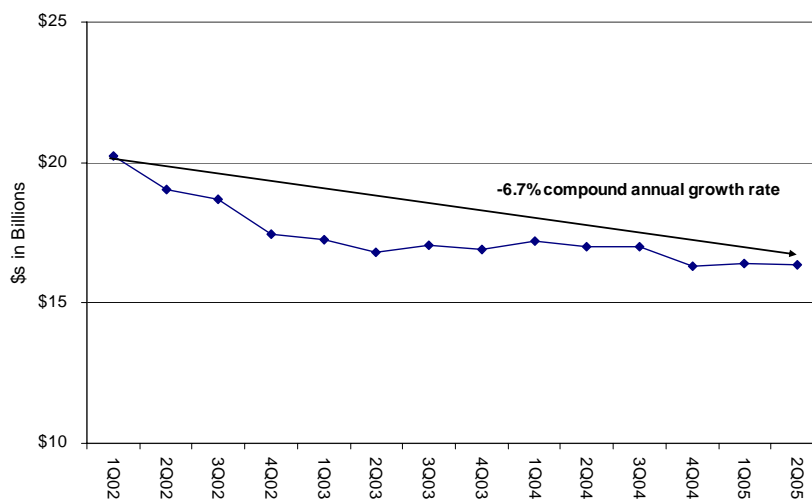
So why is universal service attracting such negative attention lately? Briefly, it's getting squeezed from both ends. More and more voice communications traffic is circumventing universal service contributions mechanisms, while more and more companies (mostly wireless carriers) are being designated as eligible telecommunications carriers (ETCs), eligible to receive universal service support. And to make matters worse, it is apparent that current policy provides a windfall to most new ETCs by allowing the new ETCs to receive the same level of universal service support as incumbent ETCs, regardless of the new ETC's costs of providing service. This policy is referred to as the "identical support" rule.<sup>5</sup> Part of the incumbent's universal service

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<sup>5</sup> See Reply Comments of the Montana Public Service Commission. *In the Matter of the Federal-State Joint Board on Universal Service, Request for Comments on Certain of the Commission's Rules Relating to High-cost Universal Service Support*. CC Docket No. 96-45. December 14, 2004. "To further illustrate the need to eliminate the identical support rule we offer the following information. Western Wireless' CEO, John Stanton, in his presentation to this fall's Qwest Regional Oversight Committee (ROC) meeting of September 12 and 13, [2004] Missoula, Montana, presented estimates of relative wireline and wireless investment costs. Those costs are as follows: (1) national wireline carriers' cost is \$2,492; (2) national wireless carriers' cost is \$920; (3) rural wireline carriers' cost is \$7,195; and (4) rural wireless carriers' cost is \$1,734. It is

support which a new ETC “inherits” is “new money” to the new ETC resulting from previous regulatory policies that replaced a portion of access revenues for incumbent telcos. Thus, universal service support to wireless carriers is growing substantially and dramatically, while support to incumbent wireline companies has remained essentially constant.

The following chart illustrates the shrinking universal service contribution base.



Source: FCC

Meanwhile, universal service distributions are accelerating, mostly as a result of designation of additional wireless ETCs. In 2000, non-incumbent ETCs received \$1.5 million in universal service support. By 2006, funding to competitive wireless ETCs is expected to approach \$1billion.

The following chart shows the relative growth of the universal service fund by competitive ETCs (CETCs), while incumbent local exchange carriers (ILECs) support has remained relatively stable, with the exception of access revenue replacement rulings which simply moved existing ILEC revenues from access to universal service.

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apparent from the presentation that to base support to wireless carriers upon the cost of the ILEC would bequeath an extraordinary subsidy to the wireless industry.” [Emphasis added.]

	Funding in \$millions			% of USF		Growth in funding			Incremental ILEC funding (2)
	CETC	ILEC	Total	CETC	ILEC	CETC	ILEC	ILEC w/o (2)	
1998	.	1,696.6	1,696.6	0%	100%	-	-	-	
1999	.5	1,723.1	1,723.7	0%	100%	-	1.6%	1.6%	
2000	1.5	2,515.3	2,516.8	0%	100%	179.1%	46.0%	17.0%	\$500M from reg. chngs., including IAS
2001	20.2	2,583.2	2,603.4	1%	99%	1251.1%	2.7%	2.7%	
2002	47.5	2,934.5	2,982.	2%	98%	135.3%	13.6%	5.5%	\$210M from reg. chngs., including ICLS
2003	131.5	3,141.8	3,273.2	4%	96%	176.8%	7.1%	2.6%	\$130M from reg. chngs., including ICLS/IAS
2004	333.1	3,154.5	3,487.7	10%	90%	153.4%	0.4%	0.4%	
2005E	719.4	3,174.2	3,893.5	18%	82%	115.9%	0.6%	0.6%	

Source: USAC; projections by Balhoff & Rowe and are based on USAC's 2Q05 estimates for full year

In summary, ninety-seven percent of new ETCs are wireless carriers. They receive 100% of the incumbent carriers' universal service support, even though part of the incumbent's support is due to regulatory policies which shifted implicit support from access payments to universal service support. Wireless carriers never received access payments, but they receive access replacement through universal service. Further, to the extent that new ETCs' costs are lower than incumbents', receipt of incumbent universal service support constitutes a windfall, as noted above. The identical support rule, in other words, needs to be eliminated.

As FCC Chairman Kevin Martin noted last October at a meeting of USTelecom,

*The current fund totals nearly \$7 billion dollars and a lot the fund's growth in recent years is attributable to new competitive eligible telecommunications carriers (or CETCs), particularly wireless CETCs, that have begun to receive funding.*

*The number of CETCs is increasing dramatically and is one of the primary drivers of fund growth. Since 2000, CETC high cost payments have grown from about \$1.5 million annually to about \$333 million annually.*

*Over the past few years, I have repeatedly expressed my concerns with the Commission's policies of using universal service support as a means of creating competition in high cost areas.*

*I do not believe it is viable in the long term to continue subsidizing multiple competitors to serve areas in which costs are prohibitively expensive for even one carrier...--Kevin Martin, Chairman, FCC. Speech to USTelecom. 10/26/05. [Emphasis added.]*

Clearly, while the intent and benefits of universal service remain valid, universal service funding is threatened by the dual problems of: 1) diminishing



contributions to the Universal Service Fund by voice communications providers who should be, but are not necessarily, contributing their share to the Fund; and, 2) distribution of support to an ever-growing number of new ETCs—as exacerbated by the identical support rule.

As FCC Chairman Martin and many others have noted, when designating additional ETCs, it is important to distinguish between promoting and advancing access to affordable, advanced telecommunications capabilities (i.e. universal service), on the one hand; and subsidizing competition, particularly in areas where even the existence of a single telecommunications provider requires support. Returning to the highway analogy, we do not need to build parallel, redundant highways, especially in areas where infrastructure is sufficient to carry all traffic.

### How to Put the Universal Service Fund Back on Track

Universal service, like the highway system, works; and it works well. It should not be considered a rural subsidy, any more than the national highway system is a rural subsidy. In fact, most of the largest beneficiary states in terms of universal service dollars are not necessarily commonly identified as rural states.<sup>6</sup> All Americans, no matter where they live, depend on an interconnected, robust interstate communications infrastructure.

That said, the squeeze on revenues and disbursements needs to be addressed. Broadening the base of contributions not only will enhance the Fund's revenues, but will address regulatory arbitrage issues in which some carriers seek to avoid contributing to the Universal Service Fund.

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<sup>6</sup> For example, Texas, Mississippi, and Kansas are the largest recipients respectively of universal service high cost support. Universal Service Administrative Corporation (USAC). HC02, High Cost Support by State, 1<sup>st</sup> Qtr., 2006. <http://www.universalservice.org/about/governance/fcc-filings/2006/Q1/HC02%20-%20High%20Cost%20Support%20Projected%20by%20State%20-%201Q2006.xls>.

On the distribution side, requiring greater scrutiny of the ETC designation process, and eliminating the identical support rule will go along way toward returning the Fund to balance without burdening telecommunications consumers.

H.R. 5072, introduced by Energy and Commerce Committee members Lee Terry (R-NE) and Rick Boucher (D-VA) proposes a series of remedies for the contribution and distribution pressures faced by the Universal Service Fund. Briefly, the bill expands the base of contributors to the fund to include all providers of voice communications; and it rationalizes distribution of funds by providing for more scrutiny over the designation of ETCs. MTA endorses H.R.5072 and encourages this Committee to pass and report this important legislation expeditiously so that the House can use H.R.5072 as a benchmark going into conference with the Senate which planning to mark up S.2686 this week amending universal service statutes among other things.

#### Universal Service Promotes Network Efficiencies

Some critics of universal service allege that telecom providers “gold plate” their networks, and lack incentives to invest efficiently in their networks. Such accusations are not borne out in reality. Rural telcos are exemplary in their commitment to service, investment, and support of their local communities. Rural communities, and likely all business managers, know the value of a dollar. Moreover, contrary to the allegations, their continual investment in modernization of their networks is creating efficiencies that reduce the distributions from the universal service Fund. For example, a digital switch, traditionally the principal brains of a telecommunications network cost somewhere in the \$1 million range. Modern Internet protocol (IP) based “softswitches” can deliver the same functionality—and more—for a fraction of the cost. Similarly, fiber optics provide far more capacity and are easier to maintain (once installed—at considerable expense), thereby creating long term efficiencies and cost savings over the life of the asset.

Consequently, Blackfoot Telephone Cooperative of Missoula, Montana, for example, is investing in an Ethernet broadband backbone which will enable it to push faster, more robust service options to the edges of its network. Simultaneously, the company is drawing \$500,000 less in universal service support. 3 Rivers Telephone Cooperative of Fairfield, Montana, received \$1.5 million less in universal service support in 2005 than the year-earlier period for similar reasons.

### Conclusion

Universal service continues to contribute substantially to on-going investment in America's affordable, quality telecommunications infrastructure which enables consumers and businesses to expand their economic and social horizons through access to world wide information. Congress has an opportunity this year to preserve and advance universal service while addressing stresses, strains and abuses that have developed since 1996. A healthy, balanced universal service program will ensure that Americans will benefit from access to a quality, affordable, advanced telecommunications network that supports America's worldwide competitiveness for years to come.

MTA looks forward to working with the Energy and Commerce Committee and other interested parties in developing policies that can preserve universal service's laudable goals while mitigating deficiencies in the program.

### Suggested Reading

“Universal Service: Rural Infrastructure at Risk.” Release 2.0. McLean & Brown. April, 2006. [http://www.mcleanbrown.com/usf\\_406.pdf](http://www.mcleanbrown.com/usf_406.pdf)

“The Rural Difference.” White Paper #2. Rural Task Force. January, 2000. [http://www.wutc.wa.gov/rtf/old/RTFPub\\_Backup20051020.nsf/?OpenDatabase](http://www.wutc.wa.gov/rtf/old/RTFPub_Backup20051020.nsf/?OpenDatabase).

Findings include:

- RLECs serve 8% of nation's access lines; 38% of U.S. geography
  - [In Montana, RLECs serve 32% of lines; 80% of land.]
- Ave. urban density = 134 customers/sq. mi.
  - National rural average is 10.5/square mile
  - [Montana average is less than 3 per mile.]
- Ave. urban customers per switch: 13,314
  - National rural average: 2,201
- Ave. cost to serve urban customer: \$240/yr.
  - National rural average cost/customer: \$337/yr.
- Rural carriers lack economies of scale and density
  - Fewer customers, and fewer high-volume customers
- Rates recover less investment cost for rural providers than urban providers
  - 50% to 75%+ of all rural providers' revenues come from “access” fees and universal service (i.e., NOT rates)

### About the Montana Telecommunications Association

The Montana Telecommunications Association (MTA) represents independent telecommunications service providers throughout Montana, offering local and long distance residential and business phone services, as well as a full spectrum of other services including broadband and dial-up Internet; satellite TV, and competitive local exchange services.

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